## APPENDIX I.

(74 California Decisions 96.)

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S. F. No. 12535. In Bank. July 2, 1927.

The Pacific Telephone and Telegraph Company (a Corporation), Applicant, v. State Board of Equalization of the State of California and John C. Corbett, Fred E. Stewart, R. E. Collins, H. G. Cattell and Ray L. Riley, as members of and constituting the said State Board of Equalization, Respondents.

[Page 97]:

Application for writ of mandate prayed to be directed to the State Board of Equalization, to compel the listing of certain leased property as operative. Writ *denied*. Preston, J., *dissents*.

For Petitioner—Pillsbury, Madison & Sutro; Oscar Lawler; Lawler & Degnan, of Counsel.

For Respondents—U. S. Webb, Attorney-General; Frank L. Guerena, Deputy Attorney-General; Everett W. Mattoon, County Counsel; J. A. Tucker, Deputy County Counsel; Dixwell Pierce, Amicus Curiae.

This application for a writ of mandate involves the question whether or not improved real property, leased by a telephone company and used by it in the operation of its business in this state, is subject to local taxation. Pursuant to section 3665c of the Political Code the Pacific Telephone and Telegraph Company, in April of this year, filed with the State Board of Equalization its annual report, showing in detail (among other items) all its property which it claimed came within the definition of operative property. It included in the report improved real

property located in the cities of San Francisco, Oakland and San Jose, which, while used exclusively in the operation of its telephone business, is not owned by the Telephone Company, but by others, and leased to it. The several county assessors protested against the inclusion of these properties as operative, on the sole ground that they are leased, and not owned, by the Telephone Company. The Board of Equalization, after due hearing, advised the Telephone Company that it has sustained the protests of the assessors on the ground specified. This application for a writ of mandate is to compel the Board to reverse its ruling and to list the leased properties as operative, thereby rendering them exempt from local taxation.

Prior to 1910 the Constitution of California provided that all property in the state, not exempt under the laws of the United States, should be taxed in proportion to its value, to be ascertained as provided by law. Under the amendment of that year, providing for the separation of state and local taxation, and for taxing certain public service corporations for state purposes only, it is now provided that all property in the state, except as otherwise in the Constitution provided, not exempt under the laws of the United States, shall be taxed according to its value, to be ascertained as provided by law, "or as [in the Constitution] provided", and that "in lieu of all other taxes and licenses, state, county and municipal," all telephone and other enumerated companies "shall annually pay to the State upon their franchises * * * poles, wires, pipes, canals, conduits, rights of way, and other property, or any part thereof used exclusively in the operation of their

[Page 98]:

business in this State," a tax measured by a given percentage of gross receipts, equal, in the case of telephone companies, to five and one-half per cent upon the gross receipts from operation within the state. (Const., art. XIII, secs. 1 and 14 [a].) The underlying theory of taxation in this state has always been that the owner of property subject to taxation must pay the tax. It needs no citation of authority to that effect. Our whole scheme of taxation rests upon that theory. (Pol. Code, sec. 3628.) Petitioner is here contending, however, that in the case of the "operative" property of companies liable to taxation for state purposes only, it is unity of operation in the use of property, regardless of ownership, and not ownership, that determines who shall pay the tax. It takes the position that, as the leased buildings are used in its business, and as part of its telephone system, they are operative property and contribute to its revenues, and, consequently, to the amount of its taxes, in no way different from property owned by it, for which reason it contends that it should not pay the gross receipts tax to the state and also pay the local taxes on property the use of which yields the gross receipts. The false quantity in its reasoning is that petitioner will not be liable for the tax if the leased property be locally assessed. No matter how we may decide the controversy, the amount to be paid by the petitioner as its state tax will not be affected. It must pay the fixed percentage on its gross receipts. Neither will the amount of local taxes which the petitioner is required to pay by the tax laws of the state be affected. For the usual purposes of taxation this state does not recognize any segregation of interest between a leasehold and the

reversion. The whole tax is assessed against the owner of the fee, and the tax, in the absence of any agreement between the lessor and the lessee, will be paid by the owner. If the petitioner in this case is compelled to pay the local tax it is because it has voluntarily agreed with the lessors to do so.

The question involves a construction of the section of the Constitution. It is undoubtedly true that property used in the public service frequently acquires a value in the use which is something greater than the value of the property not engaged in such use. By the systemization and unification of such properties in use they in the aggregate acquire a special value by virtue of this unity of use. It is on the theory that a fair tax upon gross earnings of the utility bears such a relation to the values of these properties under their unity of use as to justify a tax upon revenue as being a legal and commutated, or substituted, tax for other taxes which previously were or might be levied that the courts have sustained the present method of taxing public service companies. (*Pacific Gas and Electric Co. v. Roberts*, 168 Cal. 420, 425, 143 Pac. 700.) Petitioner cannot claim that before the change in the method of taxing public service companies went into effect it was liable for taxes levied on leased property occupied by it and used in its business. This court has always considered the present form of taxing such companies to be in fact what it purports to be, namely, a tax upon the property of the utility as it is described in the Constitution. (*Pullman Co. v. Richardson*, 185 Cal. 484, 489, 197 Pac. 346.) We are now asked to enlarge section 14, supra, beyond its commonly accepted scope, and to place upon its provisions an interpretation which we be-

lieve the entire context of the section does not warrant. We may concede that it is the use of the property that determines whether or not it is "operative" in character [Page 99]:

(*San Bernardino v. State Board of Equalization*, 172 Cal. 76, 79, 155 Pac. 458); but it is "use by the owner" that fixes its status. We are of the view that the provision in section 14 that, in lieu of all other taxes and licenses, telephone and other companies shall annually pay to the State upon *their* franchises, etc., and other property, or any part thereof used exclusively in the operation of *their* business, a tax measured by a given percentage of gross receipts, limits the property on which such tax must be paid to property owned by the companies, and cannot be held to include leased property not owned by them. In addition to what we accept as the plain meaning of the constitutional provision, through the use of the pronoun "their" in pointing out the property liable for the substituted tax, we cite, in support of our conclusion, the reason for and history of the adoption of the amendment (see *San Francisco v. Pacific Tel. & Tel. Co.*, 166 Cal. 244, 135 Pac. 971), circumstances connected with its adoption, and legislative action following its ratification. While such matters are not conclusively binding on the court, they are of assistance in the present case, for they confirm our view as to the proper construction to be applied in the case.

While the constitutional amendment of 1910 worked a radical change in the system of taxation in this state, the purpose of which was to divide the subjects of state and local taxation by imposing upon persons and corporations engaged in certain callings the obligation to pay taxes to

be applied exclusively to state purposes, the tax imposed by article XIII, section 14, is not radically different from the tax provided by the Constitution before the amendment. Under the old system, the property and franchises of the companies, now specially set apart, were taxed for both state and local taxes. The amendment merely creates a *new method of taxing such property* and franchises, and appropriates the revenue so raised to state purposes solely. (*San Francisco v. Pacific Tel. & Tel. Co.*, supra.) The tax so imposed remains essentially a property tax. (*Pullman Co. v. Richardson*, 185 Cal. 484, 487, 197 Pac. 346.) In submitting the proposed change to the people in 1910, the commission on revenue and taxation, in its analysis of the provisions of the constitutional amendment, contained in its report (p. 18), says (italics added): "It [the amendment] leaves the old sections unchanged, except in so far as they are modified by the new section • • • The amendment provides that certain taxes on the *property* of certain classes of companies, as named and described below, shall be exclusively for state purposes. *It leaves the old system of ad valorem taxation on property in general, other than that of the classes named*, for the use of the counties, cities, school and other districts. • • •

"The taxes reserved for the state are:

"(1) On the operative *property of* railroad companies, etc.

"(2) On the *property of* sleeping car • • • etc., companies, etc.

"(3) On the *property of* express companies, etc.

"(4) On the *property of* telegraph and telephone companies, etc.

"(5) On the *property of* all light, heat and power companies, etc.

"All the non-operative property of the above corporations is left subject to local taxation."

It seems most reasonable to say that the commission, in explaining to the voters the nature of the change to be brought about by the new system of taxation, used, and expected the people to understand, the expression "prop-
[Page 100]:
erty of" in the plain and ordinary sense of "belonging to", and as indicating ownership in the public service companies which at that time were assessed for and were compelled to pay local as well as state taxes on all property owned by them. Property not owned by the companies, but leased to them, was not assessed to them, and they were not required by law to pay taxes, state or local, thereon.

When, following the adoption of the amendment, it enacted the necessary procedural statutes for carrying the new scheme of taxation into effect (see Stats. 1911, p. 530), the legislature declared (see Pol. Code, sec. 3665b) that the term "operative property", as used in the code and as applied to telegraph and telephone companies doing business in the state, shall include [subd. (d)]: "The franchises, rights of way, poles, wires, pipes, conduits, cables, switchboards, telegraph and telephone instruments, batteries, generators, and other electrical appliances, and exchange and other buildings used in the telegraph and telephone business and so much of the land on which said buildings are situate as may be required for the convenient use and occupation of said buildings." In subdivision (e) occurs the following: "• • • the opera-

tive property of the companies enumerated in this section, shall also include any other property not above enumerated that may be reasonably necessary for use by said companies exclusively in the operation and conduct of the particular kinds of business enumerated in section three thousand six hundred sixty-four a of this code." Because of the occurrence of the phrase "exchange and other buildings *used* in the telegraph and telephone business" in subdivision (d), and of the general definitions last quoted (subd. [e]), petitioner argues that the legislature has made unity of use in the business the test of whether or not the property is operative. We need not discuss this contention further than to say that, if the definition of "operative property" in the code is not in harmony with the Constitution, the provision in the Constitution must prevail. (*San Diego etc. Ry. v. State Board*, 165 Cal. 560, 565, 132 Pac. 1044; *Lake Tahoe Ry. etc. Co. v. Roberts*, 168 Cal. 551, 556, 143 Pac. 786.) But we are of the view that, considered in their entirety, the code sections are in harmony with the Constitution on this matter. The next succeeding section (3665c) makes it mandatory upon each of the public service companies, when filing its annual report to the State Board of Equalization, to report in such detail as the board shall prescribe "all of *its property* [italics added] in this state which comes under the definition of operative property" in section 3665b. By another provision (sec. 3668c) the legislature made the taxes for the support of the state, under the provisions of the Constitution (supra) and the sections of the Political Code enacted to carry them into effect, a lien upon all the property and franchises of every kind and nature *"belonging to"* the companies subject to taxation for state purposes, the tax to have the effect of

an execution duly levied against "all property of the delinquent". The primary meaning of the phrase "belonging to" is "to be the property of". (7 C. J. 1039.) The judgment is not satisfied, nor the lien removed, until the tax, penalty and costs are paid, or the property sold for payment. We, therefore, conclude that, in order that the companies whose property is subject to taxation for state purposes may claim an exemption of their operative properties from local assessment and taxation, it must [Page 101]:
first appear that the property belongs to the claimant, that is, in the sense that it is owned by it.

The fact that the leased buildings contribute to the company's receipts is immaterial, unless such property comes within the constitutional definition of the property set aside for taxation for state purposes. (*Lake Tahoe Ry. etc. Co. v. Roberts*, supra, p. 555.) The further contention that, unless it be held that leased property may be operative property, it will be subjected to double taxation, and that a "serious constitutional question" will arise, is answered by the decision of this court in *Bank of California v. Roberts*, 173 Cal. 398, 403, 160 Pac. 225. If petitioner has voluntarily assumed a contractual obligation to pay a tax it is not required by law to pay, it should not be permitted to use that fact as the basis for a claim of double taxation.

We have examined the authorities relied upon by the petitioner to support its claim for an exemption of the leased buildings from local taxation. Almost the precise question submitted by the application now before us was considered in *Southern California Telephone Co. v. Hopkins*, 13 Fed. (2d) 814, in a case involving certain parts

of "talking sets" leased by the Telephone Company from another corporation and used as integral parts of certain instruments in the operation of the company's business. The Circuit Court of Appeals held that unity of use, and not ownership, determined whether or not the property was properly classed as "operative" under the provisions of the California Constitution. The cause has been transferred to the Supreme Court of the United States, where it now awaits final decision. We find ourselves in direct disagreement with the construction adopted by the federal court, because of what we believe to be the plain intent and meaning of the constitutional provisions. In *Merrill Ry. & L. Co. v. City of Merrill*, 119 Wis. 249, 96 N. W. 686, the court was construing a statute subjecting those engaged in operating street railways to a charge graduated upon their gross revenues, in lieu of other taxation, and which provided that other property "owned and actually and necessarily used by such person, company or corporation in the operation of its business", should be exempt from taxation. By a divided court it was held that, under a liberal construction, the word "owned", as used in the statute, might be satisfied by something less than absolute and entire ownership, and that a leasehold interest was not subject to local taxes. Mr. Justice Marshall, dissenting, was of the view that the court should have gone only so far as to hold exempt all property which would be taxable by the general system of taxation to the railroad company if it were not for such license method. "To go further," he says, "and include property taxable to other persons under such general system and justify it by the power of the court to judicially construe, goes outside the limits of such power into that of legisla-

tion." In *City of Superior v. Allouez Bay Dock Co.*, 166 Wis. 76, 164 N. W. 362, unity of use of the property taxed does not appear to have been considered, the question being whether or not the defendant dock company was, in legal effect, a railway company under the terms of the statute, and hence not subject to an income tax. Neither does that question appear to have been involved in *City of Detroit v. Detroit Manufacturers R. R. Co.*, 149 Mich. 530, 113 N. W. 365. The question was whether or not the defendant was a railroad company organized under the general railroad law, or to be considered a street [Page 102]:

railway. The cases from Illinois (*e. g., People v. Wiggins Ferry Co.*, 257 Ill. 452, 100 N. E. 956) hold that, for the purpose of taxation under the peculiar statute of that state, a railroad company is the owner of land occupied by it for its right of way, without regard to where the fee title to the land rests. We deem it unnecessary to cite the further authorities relied on by petitioner. Other than the two first above cited, they deal with questions so unlike those involving our own Constitution and statutes that they are useful only by way of illustration. After reading all these decisions, we are still of the view that this court is not justified in extending the provisions of section 14 of article XIII of the Constitution, providing a substituted tax for public service corporations, by applying it to property not taxable to them by our system of taxation before the amendment was adopted.

During the argument, the suggestion was offered that relief, to a certain extent, might be accorded to the petitioner through regarding its interest in the leased properties as operative property, the value of such interest to

be considered as proper deductions by the respective local assessors when making the assessments against the owners. The law makes no specific provision for separate assessment of leasehold interests to the lessor and reversion to the owner. While it has come to be regarded as settled law that, where the state or other public authority owns the reversion, the private owner of a leasehold interest is not exempted from paying the tax upon his interest because the interest of the state is not taxable, in the ordinary case the value of the leasehold is included in the value assessed to the owner of the fee. (*San Pedro etc. R. R. Co. v. Los Angeles*, 180 Cal. 18, 23, 179 Pac. 393.) Assessment of possessory rights under leases for the extraction of oil and like substances from the land has been held to be proper, because of their essential difference from the ordinary possessory interests under leases. (*Mohawk Oil Co. v. Hopkins*, 196 Cal. 148, 236 Pac. 133.) In ordinary cases, however, the whole property is taxed to the owner, and which party shall bear the burden is not a matter of public concern.

The respondent Board of Equalization, having correctly ruled that the property here in question is not subject to taxation for state purposes, the application for the writ is denied.

WASTE, *C. J.*

We concur:
CURTIS, *J.*
SHENK, *J.*
LANGDON, *J.*
SEAWELL, *J.*

I dissent: (Opinion to be filed.)
PRESTON, *J.*

## APPENDIX II.

(74 California Decisions 102.)

S. F. No. 12536. In Bank. July 2, 1927.

Southern California Telephone Company (a Corporation), Applicant, v. State Board of Equalization of the State of California and John C. Corbett, Fred E. Stewart, R. E. Collins, H. G. Cattell and Ray L. Riley, as members of and constituting the said State Board of Equalization, respondents.

Application for writ of mandate prayed to be directed [Page 103]:
to the State Board of Equalization, to compel the listing of certain leased property as operative. Writ *denied*. Preston, J., *dissents*.

For Petitioner—Pillsbury, Madison & Sutro; Oscar Lawler; Lawler & Degan, of Counsel.

For Respondents—U. S. Webb, Attorney-General; Frank L. Guerena, Deputy Attorney-General; Everett W. Mattoon, County Counsel; J. A. Tucker, Deputy County Counsel; Dixwell Pierce, Amicus Curiae.

This application for a writ of mandate involves the precise question this day decided in Pacific Telephone and Telegraph Company v. State Board of Equalization (S. F. No. 12535), which is whether or not improved real property leased by a telephone company, and used by it in the operation of its business in this state, is subject to local taxation.

Pursuant to section 3665c of the Political Code the Southern California Telephone Company, in April of this year, filed with the State Board of Equalization its annual report, showing in detail (among other things) all its

property which it claimed came within the definition of operative property. It included in the report certain real property, together with the improvements thereon, situate in the city of Los Angeles, and not owned by it, but leased to it, and used exclusively in the operation of its telephone and telegraph business in said city. The county assessor of Los Angeles county protested against the inclusion of this property as operative property, on the sole ground that it was leased and not owned by the Telephone Company. The Board of Equalization, after due hearing, advised the Telephone Company that it has sustained the protest of the assessor on the ground specified. This application for a writ of mandate is to compel the Board to reverse its ruling and to list the leased property as operative.

For the reasons and on the grounds stated in the decision in Pacific Telephone and Telegraph Co. v. State Board of Equalization, supra, the application for a writ is denied.

WASTE, *C. J.*

We concur:

CURTIS, *J.*
SHENK, *J.*
LANGDON, *J.*
SEAWELL, *J.*

I dissent:

PRESTON, *J.*

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IN THE

# SUPREME COURT

OF THE

# UNITED STATES

ED. W. HOPKINS, Assessor of the County of Los Angeles, State of California; E. M. ROSS, Deputy Assessor of the County of Los Angeles, State of California; W. O. WELCH, Tax Collector of the County of Los Angeles, State of California, and COUNTY OF LOS ANGELES, a body corporate and politic,

*Petitioners,*

vs.

SOUTHERN CALIFORNIA TELEPHONE COMPANY (a corporation), and THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY (a corporation),

*Respondents.*

## Petition for Rehearing or Modification of Decree.

*To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:*

The undersigned attorneys for petitioners respectfully desire to file this petition for a limited rehearing or modification of the decree rendered in the above entitled matter on the 3rd day of January, 1928.

### Basis of Petition.

This petition is based upon our belief that a reading of the decision previously rendered herein shows that this court has erred, due to our fault in presentation of the

case, in two regards which are the sole grounds of this application:

(1) The gross receipts tax paid by telephone companies *since it varies in proportion to the property owned by them must be a property tax thereon.* It cannot be a *property tax* on other property any more than it can be a *property tax* on salaries paid employees.

(2) Section 14 of Article XIII of the California Constitution had been interpreted by the state courts prior to this decision in such a manner as clearly to necessitate a construction of operative property by this court as that *owned by* the telephone company.

The portion of the decision relied upon in both regards is set forth in the concluding paragraph appearing on page 8 of the pamphlet opinion and reads as follows:

> "We think the purpose of the 1910 Amendment is to tax all operating property of a telephone company by ascertaining the gross receipts and taking therefrom the specified percentage. Thus, the imposition becomes approximately equal to what other property bears. *Unless the gross receipts tax be so treated, some very serious questions under the Federal Constitution are almost certain to arise. Without any authoritative holding by the State Supreme Court to the contrary, we must conclude the leased speaking sets are not subject to local taxation.*" (Our italics.)

This court has quite properly interpreted a question of state law contrary to our position, if:

(1) It is necessary to reach such a determination to avoid "serious questions under the Federal Constitution."

(2) There is no "authoritative holding" by the state courts which precludes this court from giving a

construction to Section 14 of Article XIII of the California Constitution contrary to that urged by respondents.

We earnestly and respectfully believe that neither assumption is correct.

I.

## NO "SERIOUS QUESTIONS UNDER THE FEDERAL CONSTITUTION" WOULD ARISE OUT OF A CONSTRUCTION OF OPERATIVE PROPERTY OF TELEPHONE COMPANIES AS LIMITED TO THAT OWNED BY THEM.

The serious question under the Federal Constitution which the court seems to anticipate is set forth on page 7 of the pamphlet decision, as follows:

> "If payment of the prescribed part of the gross receipts only relieves from local taxation property actually owned and leaves all held under lease subject thereto, inequalities with possible confiscation, would certainly result. Under that theory a corporation with title to half (in value) of its operative property, the remainder being leased, would really pay on account of the portion owned at twice the rate required of another corporation operating the same amount of property and having equal receipts, but holding nothing by lease. And if the ratio between property owned and leased were less, the difference in rate would be still greater. A telephone company which leased everything it used would release no property from taxation by paying the gross receipts tax, while a competitor with equal receipts, by paying the same amount, might absolve from local assessment property of very large value."

Swayed solely by the fear that a practical application of petitioners' theory would result in an unconstitutional discrimination between utilities, this court, as we read its

opinion, rendered its decision on the question of state law not because of the apparent meaning of Section 14, *but in spite of it.* We respectfully submit that this court in so doing anticipated a contingency which can never occur.

This court must have misinterpreted the method by which respondents' gross receipts tax is computed, as we earnestly believe that it is mathematically demonstrable that no practical or legal discrimination can result from petitioners' contention, *provided the method of computation of public utility gross receipts is thoroughly presented to the court.*

The respondents, as public utilities, are subject to the jurisdiction of the California Railroad Commission and the Interstate Commerce Commission. Over ninety-six per cent of their gross operative receipts, upon which the tax of five and a half per cent is levied, is derived from rates or service charges established by these two commissions.*

*It is evident that the method used in determining these service rates must almost entirely determine respondents' gross receipts and respondents' gross receipts tax.* Although these service rates are in fact very numerous, assuming for sake of simplicity a single flat service rate, we have a mathematical equation as follows:

R × number of services = gross receipts.

Analyzing R through the medium of the reports of the Commission (see pet. br. pp. 110-120), we find it is an arbitrary figure which, when multiplied by the number

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* These were estimated for the year 1931 by the Railroad Commission in Re Southern California Telephone Company, 35 R. C. D. 731, 742, to be:

| | | | |
|---|---|---|---|
| Exchange Lines, | $11,433,000.00 | — | 81.5% |
| Toll Service, | 800,000.00 | — | 5 % |
| Miscellaneous, | 483,000.00 | — | 3.5% |
| | $13,797,000.00 | | |

of services (or service connections), will result in a product large enough, after deducting operating expenses therefrom, to produce *a fair net return upon the capital invested in property owned by the company.* (Counsel for respondents admitted at the oral argument the correctness of our analysis in this regard.)

Expressed mathematically, the formula is:

$$R = \frac{(X\% \times \text{owned property}) + \text{operating expenses}}{\text{estimated number of services}}$$

Applying the above formula to a situation where the value of the owned property or rate base was $100,000, the rate of net profit allowed was 5%, operating expenses were $100,000, and the number of services or subscribers was 10,000, we would then have a service rate or R of $19.50. Increasing the owned property or rate base to $200,000 would increase R to $[illegible].00. *Likewise the gross receipts would increase from $[illegible]000 to $[illegible]0,000 and the gross receipts tax of a telephone company, computed at 5½%, from* ~~$[illegible] to $[illegible]~~ $5775 to $6,05[illegible]

*The gross receipts tax, then, other matters remaining constant, increases and decreases with mathematical precision with the property owned by the utility.* On page 7 of its pamphlet opinion, this court approved the decision of the California courts that the gross receipts tax is "essentially one on property." *If this be so, on what property can this tax rest except that which increases or decreases the tax in strict accordance with its value?*

It is true that, if other factors vary, the gross receipts tax will also increase or decrease. In the above case if the operating expenses, because of higher salaries, had increased from $100,000 to $200,000, with no increase

in the rate base or owned property, R would have likewise increased from $12.00 to $14.00. *Can it logically be said that the increased tax which the utility must pay in such a case is a property tax upon the increased salaries of its employees? The answer is patent.*

Rentals of leased property under the rate-fixing methods followed by both the Interstate Commerce Commission and the California Railroad Commission are treated in identically the same manner as other operating expenses. It can not logically be said that the gross receipts tax under such a condition represents a tax on such leased property any more than on the salaries of the employees, *for both are treated alike.* Indeed, we respectfully submit that to hold the gross receipts tax to be a tax on the leased property is one degree more remote and illogical than to hold it a property tax upon the salaries paid employees, because the essence of the respondents' case is that the property taxed by the gross receipts tax, and therefore removed from local taxation, is not the rental but that for which the rental is paid, or the leased premises.

The instance cited of a corporation with title to half in value of its operative property, the remainder being leased, paying twice the rate required of another corporation operating the same amount of property and having equal receipts but leasing nothing, could not occur. *Two corporations under such circumstances would not have the same gross receipts unless the impossible happened and the operating expenses of the company leasing half increased exactly the amount necessary to offset the decrease in net return caused by the decrease in value of the owned property.* Slight inequality of treatment of

utilities necessarily results from the use of gross receipts as a measuring stick for a property tax. This is a defect inherent in the gross receipts method of taxation. It does not arise from any vice in the position of petitioners or respondents herein. This is shown by reference to the above cases where the two companies both with the same invested capital and leasing no property, one having a higher operating expense than the other, paid respectively 6.6% and 7.7% tax on its owned property. Such a fluctuation was anticipated by the Commission on Taxation and Revenue when it said in its 1906 report at page 159: (Appendix to Journals of Senate and Assembly, California, Thirty-seventh Session, 1907, Vol. 2, Item 6.)

> "If a road (railroad) does more business this year than last, it buys more coal, pays more wages, *and under this plan would pay more taxes.*" (Our italics.)

Assuming for sake of argument that inequalities would in fact result from petitioners' contention, it does not mean that the owned property is bearing such an increased burden as would appear at first glance. A company which could secure the same gross profits as its competitor with only half of its competitor's investment must of necessity have a tremendous franchise value over and above that owned by its competitor.

This is not a new situation or one unknown to this court. In *Adams Express Company v. Ohio*, 165 U. S. 194, this court pointed out that in that case property valued at $23,400 and consisting of wagons, horses, safes and the like had brought in revenues aggregating $275,446.00 in a single year. This court, through Mr.

Chief Justice Fuller, in upholding the Ohio gross receipts tax against an attack on the ground that the express company was taxed thereunder on a valuation of $499,377.60 instead of $23,400 said at pages 221-2:

> "No more reason is perceived for limiting the valuation of express companies to horses, wagons, and furniture than that of railroad, telegraph, and sleeping car companies to roadbed, rails, and ties; poles and wires; or cars. The unit is a unit of use and management, and the horses, wagons, safes, pouches, and furniture; the contracts for transportation facilities; the capital necessary to carry on the business, *whether represented in tangible or intangible property, in Ohio, possessed a value in combination and from use in connection with the property and capital elsewhere, which could as rightfully be recognized in the assessment for taxation the instance of these companies as the others.*" (Our italics.)

The instance of the telephone company which leased everything it used and thereby released no property from taxation by reason of the payment of the gross receipts tax is simply an illustration, stretched far beyond any actual possibility, of a corporation which had a franchise value raised to the nth degree, inasmuch as it was enabled to conduct a tremendous business without the investment of a dollar of its own capital.

*The inclusion of the franchise element in the property owned is the explanation of the practical difficulties which this court erroneously foresaw.* A comparison of the instant problem to that raised by increased salaries or other items of operating expense having nothing to do with the lease problem shows the utter futility of holding the gross receipts tax a property tax upon anything except that included in the rate base (and franchises

are so included) which, as we have shown above, excludes all leased property. We respectfully submit that respondents' interpretation of operative property will not raise any "serious questions under the federal constitution." Therefore the reason given by the court for straining the clear and apparent meaning of Section 14 of Article XIII should have no weight.

II.

## THIS COURT ERRED IN DECIDING THAT THERE WAS NO "AUTHORITATIVE HOLDING" BY THE STATE COURTS AS TO THE MEANING OF SECTION 14.

On page 5 of the pamphlet opinion, this court said:

> "No ruling of the California Supreme Court authoritatively determines whether personal property leased by a telephone company and actually used for operating purposes is relieved from local taxation by payment to the State of the prescribed percentage of the lessee's gross receipts. July 2, 1927,—after the decision below—that court handed down an opinion which declared leased improved real estate, although actually used as operating property, was subject to local taxation. *Pacific Telephone & Telegraph Co. v. State Board of Equalization*, 74 Cal. Dec. 96. But rehearing was granted and this vacated 'the previous opinion and judgment and set the whole matter at large.' *Miller & Lux Incorporated v. James*, 180 Cal. 38, 48."

Apparently this court interpreted our argument in respect to the decisions of the state courts as being predicated upon a contention that the instant case was controlled alone by the *State Board Cases*, in which the decisions had been vacated by the order granting rehearing.

We intended to emphasize our position that these decisions, although technically vacated and of no binding effect, served as nothing else could to show what was the manner of thinking on this precise point by the California Supreme Court. *As was said by one of the learned justices at the oral argument in this case, there is no reason to believe that the California Supreme Court, when this question comes before it, will not reaffirm the position which it took so firmly last July.*

However, the *State Board Cases* were simply the culmination of a long line of cases which by their decisions and language required a determination that "operative property" included only that which was owned by the operating utility. These cases emphasized, to summarize them briefly, the fact that the new form of taxation was a substitute method of taxing the same property which had previously been taxed to the utilities prior to the adoption of Section 14 in 1910. As we view it, this could only be the owned property, since prior to 1910 public utilities had not paid taxes upon property which they leased.

*Pacific Gas and Electric Co. v. Roberts*, 168 Cal. 420, 425 (1914);
*Union Tank Line Co. v. Richardson*, 183 Cal. 409, 413-414 (1920).

Due to the fact, that since the oral argument, we have found further corroboration of our contention, we desire to discuss one further case in detail. In *Pacific Gas and Electric Co. v. Roberts*, 176 Cal. 183, (1917), plaintiff was a California corporation engaged in the sale of gas and electricity. The Suburban Light and Power Co. was operating as an independent company. The gross receipts of the Suburban Light and Power Co.

were $188,401.60 which were the results of the sale of gas and electricity by said corporation. Large quantities of gas and electricity were purchased from the plaintiff for the sum of $52,717.99. Plaintiff's gross receipts were $7,816,313.12, but it in turn had purchased electricity in the amount of $972,293.52 from independent companies. The State Board of Equalization, under Section 14, had assessed to plaintiff and to the Suburban Light and Power Co. a tax at the rate of 4% upon the gross receipts of both companies without allowing any deduction for the amounts paid upon the sales of gas and electricity purchased by the Suburban Company from plaintiff or purchased by plaintiff from independent concerns. In other words, the plaintiff insisted that double taxation resulted from the computation of taxes upon the same property, to-wit, the plant of the Pacific Gas and Electric Co., the Suburban Light and Power Co., and the properties of the independent companies. In upholding the position of the State Board of Equalization, the court said at pages 188-9:

> "It thus appears and has been definitely decided by this court that the tax, whatever its scientific essence, *is levied upon property created in part by the unity of use of other property. There is a unity of use in the distribution of gas and electricity sold to its consumers* by such a corporation as the Pacific Gas and Electric Co., *whether those commodities be produced in its own retorts and by its own generators or purchased ready-made* from other corporations. The tax *might* be levied upon the gross earnings (as indeed it is in some states), but we see nothing to prevent its ascertainment by calculating a certain per cent of the 'gross receipts from operation.' Either method would be a 'commutated or substituted' tax upon *properties* which have acquired

peculiar and special worth because of their 'unity of use'." (Our italics.)

In 1922 there was proposed to the people of California as Proposition 15, a constitutional amendment which would have reversed the decision of the court in the above case. The amendment in this regard read as follows:

> "provided, that whenever any company taxed under the provisions of this section shall pay to any other such company for any commodity furnished by the latter, any money which shall upon its receipt add to and become a part of such other company's gross receipts from operation as herein defined, said sum so paid shall be deducted from the gross receipts from operation of the company paying same and the tax as herein provided shall be computed on the net amount of such company's receipts remaining after such deduction."

The proponents of this constitutional amendment in their argument to the voters, appearing at page 87 of the official pamphlet distributed to the electorate at the polls in 1922, said concerning this provision:

> "This amendment, however, goes just a little further. *It clears up two cases of double taxation by those who contribute to state support.* One of these has to do with the sale of the product of a company, which sells to another company for retailing, as happens sometimes in dealing in electric power. *That power should be taxed but once.*" (Our italics.)

This amendment was defeated. Since there was no opposing argument filed, it must be deemed that the people of California considered and decided against the proposed amendment upon the argument so used.

***It is to be noted that this argument was identical with that employed by respondents in this case, to-wit, double taxation.***

The California Supreme Court has held in the ***Roberts Case*** that Section 14 requires that a public utility selling its product must include the proceeds thereof in its taxable gross receipts even though the buyer is also a public utility purchasing for resale the proceeds of which resale are to be included in its taxable gross receipts. *This decision the people of the State of California have solemnly ratified as not only the meaning but the desired meaning of Section 14.*

No one can doubt but that the rule of *Pacific Gas and Electric Co. v. Roberts*, 176 Cal. 183, necessarily includes a situation where one utility leases its property to another utility for release to the general public. *The proceeds of the lease, like the proceeds of the sale, would have to be included in the gross receipts of both companies.*

Does not a common sense view of the decision also require the same result when for the first lessor we substitute a private corporation and instead of a gross receipts tax, which this court has denominated a "property tax" on the property leased or sold, a local property tax? *Wherein are the situations different?*

We respectfully submit that far from being the sole reliance of petitioners, the *State Board Cases* are simply an exact appliance to the facts of the instant case of a rule long established in California.

Furthermore, it is not necessary for petitioners to be able to point to a state decision on all fours with the facts presented to the federal tribunal. It is only necessary to show that the facts before this court are controlled by

principles of state law. Thereupon it becomes the duty of the federal court to apply to the situation before it those principles in such a manner that the decision of the federal court resting upon a construction of state law will not be out of line with the decisions by the state tribunals.

*Pullman v. Knott*, 235 U. S. 23, 27;
*Louisville & Nashville R. R. Co. v. Garrett*, 231 U. S. 298, 305;
*Michigan Central R. R. Co. v. Powers*, 201 U. S. 245, 291;
*Royal Mineral Association v. Lord*, 13 F. (2d) 227, 229.

## Conclusion

We, therefore, respectfully submit that there is no serious constitutional question which would arise out of the construction placed upon Section 14 by petitioners. That such a construction is one which clearly follows from the language used is, we believe, tacitly admitted by the decision of this court. This difficulty removed, we respectfully submit that the court erred in not following the clear and grammatical construction of the section.

Secondly, we submit that the court erred in holding that there was not an authoritative decision by the California courts controlling the instant case. Although the two decisions precisely determining the exact facts presented here were actually vacated by the orders granting rehearing, yet these cases were simply the application of principles established by cases long ago decided and ratified by the people of the State of California. It was not, we respectfully submit, open to this court to decide a matter of construction of the state constitution con-

trary to that necessarily following from previous decisions by the state courts.

Respectfully submitted,

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We hereby certify that the foregoing petition is presented in good faith and not for the purpose of delay; and in our opinion is well founded in point of law.

EVERETT W. MATTOON,
W. SUMNER HOLBROOK, JR.